IN THE

UNITED STATES

CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

F. W. COLER, *Appellant,* vs. HENRY F. ALLEN; PACIFIC NORTHWEST PACKING COMPANY, a corporation; THE PACIFIC NORTHWEST PACKING COMPANY, a corporation; AUSTIN CLAIBORNE, W. M. WILLIAMS and W. A. KEENE, and JOHN McGRAW, as Receiver, *Appellees.*	No. 713

APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES, FOR THE DISTRICT OF WASHINGTON, NORTHERN DIVISION.

BRIEF OF APPELLEES HENRY F. ALLEN AND JOHN H. McGRAW AS RECEIVER.

HAROLD PRESTON,
E. M. CARR and
L. C. GILMAN,
Solicitors for Appellees,

E. M. CARR,
Counsel.

FILED

LOWMAN & HANFORD STATIONERY & PRINTING CO., SEATTLE.

SEP 7 - 1901

IN THE

UNITED STATES

CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

F. W. COLER, *Appellant,*

vs.

HENRY F. ALLEN; PACIFIC NORTHWEST PACKING COMPANY, a corporation; THE PACIFIC NORTHWEST PACKING COMPANY, a corporation; AUSTIN CLAIBORNE, W. M. WILLIAMS and W. A. KEENE, and JOHN McGRAW, as Receiver, *Appellees.*

No. 713

APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES, FOR THE DISTRICT OF WASHINGTON, NORTHERN DIVISION.

BRIEF OF APPELLEES HENRY F. ALLEN AND JOHN H. McGRAW AS RECEIVER.

HAROLD PRESTON,
E. M. CARR and
L. C. GILMAN,
Solicitors for Appellees.

E. M. CARR,
Counsel.

ARGUMENT ON MOTION TO DISMISS APPEAL.

The appellees have filed and served within the rules of court a motion to dismiss this appeal, as follows:

"IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

F. W. Coler, Appellant, vs. Henry F. Allen; Pacific Northwest Packing Company, a corporation; The Pacific Northwest Packing Company, a corporation; Austin Claiborne, W. M. Williams and W. A. Keene, and John H. McGraw, as Receiver, Appellees.	No. 713.

MOTION TO DISMISS APPEAL.

Come now the appellees Henry F. Allen, complainant, and John H. McGraw, receiver herein, and respectfully move this honorable court that the appeal of F. W. Coler, intervenor herein, be dismissed, upon the ground that no service of the citation on appeal has ever been made upon the defendant Pacific Northwest Packing Company, a corporation, or upon the defendant The Pacific Northwest Packing Company, a corporation, or upon the defendant Austin Claiborne, or upon the defendant W. M. Williams, or upon the defendant W. A. Keene, and that neither one of the said defendants has ever been served with said citation upon appeal.

This motion is based upon the record herein.

E. M. CARR, Counsel.

HAROLD PRESTON,
E. M. CARR,
L. C. GILMAN,

Solicitors for Appellees Henry F. Allen and John H. McGraw, Receiver."

The action was brought by appellee Henry F. Allen in the lower court to foreclose certain mortgages given to him by the corporation defendants. Appellant obtained leave, as a judgment creditor of the corporation, to intervene in the foreclosure suit. He filed an intervening complaint attacking the validity of complainant's mortgages and asserting the right of all of the creditors of the corporation to share equally and ratably in the distribution of the corporate assets. The defendants Claiborne, Williams and Keene held some of the corporate property in trust for the corporation defendant and complainant. Neither of them appeared or answered, and the bill was taken *pro confesso* as against them. The defendant, The Pacific Northwest Packing Company, was the successor of the defendant Pacific Northwest Packing Company, and had become the owner and holder of all of the property originally owned by the first named corporation defendant, and had become obligated for all of the indebtedness of that corporation. It answered the complainant's bill of complaint and resisted the foreclosure of the mortgages. It appears from the record that no service of the citation on appeal has ever been made upon any of the defendants above named. It is clear that the defendant The Pacific Northwest Packing Company at least is directly interested in the decision of the questions involved in this appeal. Upon the decision of that appeal depends the question of whether the complainant, as mortgagee, is entitled to receive the proceeds of the property mortgaged to him, or whether those proceeds shall be distributed equally and ratably amongst all the creditors of the corporation.

In support of the motion we consider it only necessary to cite the case of

American Loan & Trust Co. vs. Clark, 83 Fed , 230.

decided by this court, and the decision of the Supreme Court of the United States in

Davis vs. Mercantile Trust Co., 14 Sup. Court Rep., 693.

Without waiving the motion to dismiss the appeal, appellees respectfully ask leave to present the following statement and argument on the case upon its merits.

STATEMENT OF THE CASE.

On and prior to the 20th day of October, 1898, the defendant Pacific Northwest Packing Company was a corporation, organized and existing under and by virtue of the laws of the state of Washington, engaged in the business of catching, buying, packing and selling salmon. On the 20th day of October, 1898, the said defendant had become indebted to the appellee Henry F. Allen in the sum of $15,000. From the answer of the defendant The Pacific Northwest Packing Company, the successor of the said defendant Pacific Northwest Packing Company, set out in the printed record, which answer is undisputed by appellant, it appears that a very intimate relation had existed and did exist between the said defendant and the appellee, and that in fact the appellee was the principal if not the only source of pecuniary supplies for the said defendant, and that the advances made by the appellee, and undertaken to be made by him, had enabled the said defendant to carry on its said business. It is alleged in the said answer:

"That the indebtedness owed by it to complainant, as narrated in complainant's bill of complaint, arose out of a relation between this defendant and complainant (Allen), by virtue of which complainant (Allen) was to advance and did advance divers sums of money from time to time, being the sums set out in the bill of complaint, to this defendant, and was to receive and did receive in return the output of this defendant's cannery."

On the said 20th day of October, 1898, the defendant Pacific Northwest Packing Company, for the purpose of securing the indebtedness then existing from it to the appellee, executed

and delivered the mortgage of that date set out and described in the bill of complaint. Thereafter, and up to the 11th day of May, 1900, the appellee advanced further sums to the said defendant and its successor, The Pacific Northwest Packing Company, aggregating the sum of $25,734. On the said 11th day of May, 1900, the defendant The Pacific Northwest Packing Company, for the purpose of securing the payment of the said further advances, and for the further purpose of securing other advances then undertaken to be made by the appellee to the said defendant for use in its business, and to enable it to carry on and continue its business, made, executed and delivered to appellee the second mortgage set out in the bill of complaint. The advances undertaken to be made by the appellee in addition to the said sum of $25,734 were thereafter made to the said defendant by the appellee from time to time, as required by the said defendant in the conduct of its business. The advances made subsequent to the execution of the mortgage aggregated more than $10,000.00. On the 8th day of September, 1900, no payments having been made by the defendant upon account of any of the said indebtedness, appellee filed in the lower court his bill for the foreclosure of the said mortgages. Upon the filing of the bill an order was made by the lower court appointing a receiver of all of the mortgaged property. Thereafter, on the 31st day of December, 1900, appellant filed in the lower court his complaint in intervention. A demurrer was sustained to the said complaint in intervention, and this appeal is from the judgment rendered upon the hearing of said demurrer dismissing said complaint in intervention.

ARGUMENT.

The complaint in intervention is based entirely upon the so-called "trust fund doctrine" as it is claimed by appellant to be established by the decisions of the Supreme Court of the State of Washington. No attack is made in the said intervening complaint upon the mortgage of October 20, 1898. It is directed entirely to the mortgage of May 11, 1900. The material allegations of the said intervening complaint as to the said mortgage are as follows:

"That at the time of giving this mortgage, the defendant The Pacific Northwest Packing Company had reached a point where its debts were greater than its property, where it could not pay in the ordinary course, where its business was no longer profitable and when it ought to be wound up and its assets distributed."

It is contended by appellant that, conceding these allegations to be true, he as a judgment creditor and all other creditors of the defendant corporation were entitled to share in a ratable and equal distribution of the property of the defendant corporation, and that the preference attempted to be given by the said mortgage was void as against the general creditors of the corporation. In support of this proposition appellant relies:

First, upon the decisions of the Supreme Court of the State of Washington as enunciating the law of that state, and

Second, upon the decision of the Supreme Court of the United States rendered in the case of *George D. Smith Middlings Purifier Co. vs. McGroarty,* 136 U. S., 237, as establishing the doctrine that the decisions of the Supreme Court of the State of Washington upon the question of the validity of preferences made, or attempted to be made, by corporations, are binding upon the courts of the United States.

In the Purifier Company case, the Supreme Court of the United States held, in effect, that the determination of the question raised as to the validity of the mortgage made by the corporation depended upon a construction of the constitution and statutes of the State of Ohio, and that the Supreme Court of that state had held that under the constitutional and statutory provisions of the state the mortgage in question was void as to general creditors.

In rendering its decision the Supreme Court was careful to point out the fact that the decision of the Supreme Court of Ohio was based upon the construction and application of the constitutional and statutory provisions of the state relating to corporations, and was careful to say in effect, that if the Ohio court had based its decision upon its view of the trust fund doctrine, the decision could not have been followed by the federal courts.

In the opinion of the Ohio court in the Rouse case, the constitutional and statutory provisions under consideration are clearly set out by the court. These provisions are very different from any existing in the State of Washington. As we read the opinion, the decision is based squarely upon the construction of the statute law. We understand what is said by the court regarding the general trust fund doctrine to be a mere expression of its views, and not necessary to the decision of the case.

It may be noted, in passing, that the allegations of appellant's complaint fall far short of bringing this case within the doctrine announced in the Rouse case. The Ohio court summed up its conclusions as follows:

"Without extending the discussion, we are of the opinion that when a corporation for profit, organized under the laws of this state, becomes insolvent, *and ceases to carry on its business or further pursue the purposes of its creation,* the corporate property constitutes a trust fund," &c., &c. (The italics are

ours.) This was a far different state of facts than are claimed to exist in this case.

Appellant, on page 5 of his brief, declares that the Supreme Court of the United States has decided that the decisions of a state supreme court on the question of corporate preferences are binding upon the federal courts. The Purifier Company case is the only case cited in support of this statement, and as we understand the decision in that case, it falls very far short of sustaining appellant's contention. To make the decision in the Purifier Company case applicable here, it would be necessary for appellant to show that the Supreme Court of the state had decided that the statute law of the state rendered void a preference given by a corporation under the circumstances set out in the appellant's complaint. As a matter of fact, no such statute exists in the state of Washington, the supreme court has not at any time claimed to have construed any such statute, and furthermore, the supreme court of the state has never decided that a mortgage given under the circumstances shown in the case at bar constituted an illegal preference.

The origin of the trust fund doctrine in the State of Washington is to be found in the case of *Thompson vs. Huron Lumber Company*, 4 Wash., 600. The decision of that case was in no wise predicated upon any constitutional provision or statute of the State of Washington. It is true that in an opinion rendered denying a petition for rehearing in that case, the court said (p. 610):

"Our decision is vigorously attacked by reason of its adoption of the trust fund theory, and it is argued that Rouse vs. Merchants National Bank, 6 O. St., 493, was decided upon Ohio statutes, of which we have none. But careful reading of that case shows that, with one or two exceptions, the statutory provisions there alluded to were identical in substance with

our own, and an examination of the statutes of Ohio on the subject of corporations further reveals the similarity. If, therefore, as it is contended, the adoption of the trust fund theory has everywhere depended upon statutes, the appellant has no ground to stand upon, for we have the substance of all the statutes on the subject, with the addition of one expressly giving jurisdiction to the courts to appoint receivers of insolvent corporations."

As before stated, the decision was not predicated upon any constitutional or statutory provision of the state. The court says that, with one or two exceptions, the statutory provisions alluded to in the Rouse case are identical in substance with those of Washington. What particular statute was being construed by the Supreme Court is not pointed out, and it cannot be found from the most careful reading of the opinion that any statute was the subject of construction.

The allusion to the statute expressly conferring upon the courts of the state jurisdiction to appoint receivers of insolvent corporations carries no weight, for that jurisdiction existed independent of any statute. The jurisdiction was inherent in the courts of the state as courts of equity. The statute did not enlarge that jurisdiction. If it curtailed it the argument would be the other way. The decision in the Thompson case and the decisions in all other cases decided by the Supreme Court of the State of Washington on the same subject were based entirely upon the trust fund doctrine as enunciated in the decisions of various state courts, and were entirely independent of any constitutional or statutory provision. All of those decisions were predicated upon the particular facts of each case.

In the Thompson case it was held by the court that "the mortgage was designed to act as a shield between the corporation and its other creditors while it prosecuted its ordinary

business for an indefinite length of time. * * *" This was the conclusion of the court, and upon this conclusion its decision was based. Having so decided, the court proceeded to say:

"But for another reason we should hold this mortgage bad. The indebtedness evidenced by the notes was long overdue; the directors of the company could not agree; the business was practically stopped and the corporation was insolvent. The insolvency was formally adjudged fifteen days after the mortgage was made, upon the petition of appellant himself." (The appellant was the mortgagee.) "In that time no material change took place in the company's affairs. For many months it had been embarrassed, could pay nothing upon its debts, and was merely using up its property without profit over working expenses. Ball, who was a director, knew of this; and it is useless to argue that a creditor of the dignity of a national bank was not informed. Under these circumstances, a court of equity in this state ought not to enforce any voluntary preferences attempted by the directors of a corporation."

From the above quotations it clearly appears that the decision of the court was predicated upon facts which, in the opinion of the court, clearly showed that the attempted preference was in law fraudulent. The decision of the court must be read and understood in the light of the facts which were before it. General remarks upon the theory of the law applied by the court to those facts should be and are no more binding upon any court than they were intended to be upon the court rendering the decision.

In the case of *Conover vs. Hull*, 10 Wash., 673, the court found that there had been actual collusion between the officers of the corporation, after its hopeless insolvency had become established, and certain favored creditors of the corporation,

for the purpose of giving to those favored creditors unwarranted preferences. The court said (p. 679):

"When we come to think that this preferred distribution is made by the managers, who represent the stockholders who are in no way responsible for the debt, or at least that portion of it which is in excess of their liabilities, why should they, thus disinterested, be allowed to confer these benefits upon favorites to the exclusion of the rights of other honest creditors who have helped to furnish the means which constituted the very fund which is now being distributed to the exclusion of their interests? Certainly, it is but a just provision of law which holds that this fund, under such a condition, must be held intact as a trust fund for the equal benefit of all the creditors."

Nothing further need be said in support of the proposition that the decision in the Conover case was predicated entirely upon the application of the trust fund doctrine as applied to the facts of that particular case. If anything further were necessary, it would be only to quote the concluding paragraph of the opinion in that case:

"All the circumstances surrounding this litigation convince us that the insolvent condition of this company was known to the appellants; that there was a desire on the part of the company to prefer these appellant creditors, and that the condition of the company was made known to them for the express purpose of warning them that they should not delay in the commencement of their actions; and that the result of this knowledge and action on the part of the company and of these appellants was to obtain liens upon the property of this corporation in fraud of the rights of other creditors."

In the case of *Biddle Purchasing Co. vs. Port Townsend Steel, &c., Co.,* 16 Wash., 671, cited by appellant, the court said (p. 693):

"The mortgage itself was clearly a preference by an insolvent corporation of one of its creditors. It was executed as security for an antecedent debt. Such a preference cannot be maintained."

To sustain appellant's contention that the Federal Courts are bound in this case by the decisions of the Supreme Court of the State of Washington, it should be shown that that court has held that under the constitutional and statutory provisions of the state no corporation, in fact insolvent, can create a preference in favor of one creditor to the exclusion of its other creditors. That court has not announced any such rule, and has in fact held in certain cases that preferences made by corporations in fact insolvent were valid.

The mortgage attacked by appellant was made by a corporation which was then carrying on the business for which it was organized. Regardless of the affirmative allegations contained in the answer of the defendant corporation, the truth of which are conceded by appellant, it is clear both from the appellee's bill of complaint and the intervening complaint that at the time said mortgage was given, the corporation was a going concern, carrying on its corporate business, and needing for the successful prosecution of said business advances of money. It is not claimed that complainant knew that the company was insolvent or should have so known, or that he had any reason to believe or even suspect that it was insolvent. He dealt with it as a solvent, going concern. The mortgage was not only made for the purpose of securing an indebtedness then existing, but for the further purpose of securing advances which might or might not be thereafter required by the corporation in the prosecution of its business. It appears that the further advances provided for were required and were made by the appellee to the extent of over $10,000.00. From the date of the said mortgage, May 11th, 1900, until the 8th day of Sep-

tember, 1900, it appears that the corporation continued to carry on its business without molestation, by suit or otherwise, from any of its creditors. On the 8th day of September, 1900, the appellee having received no payments on account of any of the advances made by him, began his suit for the foreclosure of the mortgages given to him. Upon that day a receiver was appointed to take charge of the mortgaged property and to hold and operate it under the orders of the lower court. The receiver's possession of the mortgaged property and his conduct of the business of the corporation was not assailed by any creditor until the 31st day of December, 1900, when appellant's complaint in intervention was filed in the lower court. That complaint in intervention, as before pointed out, was based entirely upon the allegations that at the time of giving the mortgage in question the defendant corporation had reached a point where its debts were greater than its property, where it could not pay in the ordinary course, where its business was no longer profitable, and when it ought to be wound up and its assets distributed. No knowledge of any of these alleged facts was imputed to complainant. The lower court held that this intervening complaint did not state facts sufficient to sustain the intervention and the claim made by appellant.

As clearly pointed out in the opinion of the Supreme Court of the United States in the Rouse case, the decision of the Supreme Court of the State of Ohio, so far as it was based upon the trust fund doctrine, proceeded upon the theory that the property of an insolvent corporation is a trust fund for its creditors in a wider and more general sense than could be maintained upon general principles of equity jurisprudence.

No claim is made by the Supreme Court of the State of Washington that its decisions upon this question rest upon any other foundation than that of general principles of equity jurisprudence. As before pointed out, it is true that when challenged

upon its application of these principles it stated that "*with one or two exceptions*" the statutory provisions alluded to in the Rouse case were identical in substance with those of Washington. What the exceptions are is not stated, and it is not claimed that the decision in the Thompson case is based upon the construction of any constitutional or statutory provision. It is clearly held by the Supreme Court of the State of Ohio and by the Supreme Court of the United States, in its decision upon the appeal from that case, that the decision was based upon a construction of certain constitutional and statutory provisions of the State of Ohio, and for that reason, and that reason only, the Supreme Court of the United States considered itself bound by the decision of the state court in an exactly similar case. That case was decided on May 19th, 1890.

In a later case, decided on March 25th, 1895,

Sanford Fork & Tool Co. vs. Howe, Brown & Co., 157 U. S., 312,

the Supreme Court clearly stated its position upon this trust fund doctrine. The facts in that case supporting the attack upon the mortgage made by the corporation, were far stronger than the facts alleged in the intervening complaint in the case at bar. The mortgage attacked in that case was given to the directors of the corporation itself. It was given as security for a past indebtedness, but further to induce the endorsers (the directors) to obtain for the corporation a renewal or extension of its obligations and to make further endorsements. There was a loaning to the corporation of the credit of its own directors. In the case at bar the appellee had furnished, long prior to the giving of the mortgage in question, the large sum of $15,000 for the use of the corporation in its business, and had received as security a mortgage, the validity of which is in no wise questioned. It is not made to appear, and is not even claimed by appellant, that anything whatever had been paid by

the stockholders of the corporation upon the stock of the company. It seems reasonably clear from the showing made by the original bill of complaint, the answer of the defendant corporation and appellant's intervening complaint, that the appellee had furnished practically all of the funds used by the corporation in the prosecution of its business. The corporation was still a going concern, carrying on its corporate business. It continued to carry on its business and obtained from the appellee from time to time, as its necessities arose, large sums of money, in addition to the indebtedness existing at the time the mortgage in question was made. Can it be doubted for a moment that at the time of giving this mortgage securing not only advances theretofore made without security upon the faith and credit of the value of the corporation's property and business, but also advances thereafter to be made as required in the prosecution of that business, the corporation, its stockholders and officers and the appellee regarded the corporation as a going and solvent concern? Such being the fact, can it be said that the charge made six months thereafter that at the time the mortgage was given, the corporation had reached a point where its debts were greater than its property, where it could not pay in the ordinary course, where its business was no longer profitable, and when it ought to be wound up and its assets distributed, if conceded to be true, rendered the mortgage void as to the general creditors of the corporation? Such is not the law as declared by the federal courts. As said in *Sanford Fork & Tool Co. vs. Howe, supra,* after discussing the effect of the mortgage given to the directors of the corporation:

"Nor is it the case of the directors of a corporation, in fact insolvent, though continuing and expecting to continue in business, executing a mortgage on the property of the corporation to simply secure themselves for a past indebtedness; for here the corporation, although insolvent within the rule which de-

clares that insolvency exists when the debtor has not property sufficient to pay its debts, was still a going concern and intending to continue its business, and the mortgage was executed, not simply to secure directors and stockholders for past indebtedness, but to induce them to procure a renewal or extension of paper of the company then maturing or about to mature, and also to obtain further advances of credit." (In the case at bar future advances, not of credit, but of large sums of money.) "Will it be doubted that, if this mortgage had been given to the holders of these notes, it would have been valid? Are creditors who are neither stockholders or directors, but strangers to the corporation, disabled from taking security from the corporation by reason of the fact that upon the paper they hold there is also the indorsement of certain of the directors and stockholders? Must, as a matter of law, such creditors be content to share equally with the other creditors of the corporation, because, forsooth, they have also the guaranty of some of the directors or stockholders, whose guaranty may or may not be worth anything? But even that is not this case, for here the corporation is a going concern, and intending to continue its business, and the mortgage was given with a view of enabling it to so continue, and to prevent creditors whose debts were maturing from invoking the aid of the courts to put a stop thereto. Can it be that if, at any given time in the history of a corporation engaged in business, the market value of its property is in fact less than the amount of its indebtedness, the directors, no matter what they believe as to such value, or what their expectations as to the success of the business, act at their own peril in taking to themselves indemnity for the further use of their credit in behalf of the corporation? Is it a duty resting upon them to immediately stop business and close up the affairs of the corporation? Surely, a doctrine like that would stand in the way of development of almost any new enterprise. * * * Of course, an underlying fact,

expressly stated to have existed in these transactions, is good faith. Carrying on business after the giving of an indemnifying mortgage, with a knowledge of insolvency, with the expectation of soon winding up the affairs of the corporation, and only for the sake of giving an appearance of good faith, leaves the transaction precisely as though the mortgage was executed at the moment of distribution, and with a view of a personal preference. Again, not only was the corporation a going concern, not only did the directors expect and intend that it should continue, and believe that its continuance would bring financial success, but, as appears, they did continue the business for two months, and during that time paid out in the ordinary management of its affairs and in discharge of its debts over $30,000, without appropriating a single dollar to the payment of the claims for the endorsement of which they had taken this indemnity."

Notwithstanding the peculiar embarrassment resulting from the fact that the mortgage under consideration in the case above quoted from was made directly to the directors of the corporation, the opinion of the court seems to us to be very applicable to the facts before the court upon this appeal. The corporation defendant was a going concern, its stockholders, officers and creditors expected that the continuance of its business would be profitable, and that out of the profits reasonably anticipated to accrue from the prosecution of its business it would be enabled to meet all of its obligations. In the continuance of that business it relied, and—as the result proved—with good grounds, upon the pecuniary assistance of appellee. During all this time, and until the fact had become established that, notwithstanding the expectations of all persons interested, and notwithstanding the fact that appellee had faithfully kept and performed every obligation imposed upon him by the terms of the mortgage, and had backed the opinion of the stockholders and officers of the corporation and of himself, by

the expenditure of large sums of money, the business of the corporation was not profitable, no one challenged the validity of the mortgage in question. It would have been strange, indeed, if its validity had then been questioned, for, so far as appears from any claim made by appellant, the only indebtedness owed by the defendant corporation to any other person than appellee was the comparatively insignificant sum of $1000 owed to appellant's assignor. The mortgage in question was not made secretly; it was recorded as required by the statutes of the state, and it seems clear that appellant, during all of the period of six months intervening between the making of the mortgage and his attack upon it, had not only constructive but actual knowledge of all of the facts. The allegations of the intervening complaint are so framed as to irresistibly lead to the conclusion that appellant had full knowledge of all of the dealings between the defendant corporation and appellee, and expected to reap an advantage from the pecuniary help extended by appellee to the corporation. Not the slightest imputation of collusion, fraud or even legal bad faith is made. The intervening complaint, attempted to be so framed as to bring its allegations within the rules announced by the Supreme Court of the State of Washington, utterly fails to state a case in any wise similar to the facts of any case decided by that court.

Should we concede that appellant, in his intervening complaint, has succeeded in his obvious intent to state a case within the language employed by the supreme court of the state used in justifying its decisions in particular cases, it is clear that the case so stated is not similar to any case decided by that court. Decisions of courts are valuable as authority only as applied to the facts before them. The most careful consideration of the decisions of the Supreme Court of the State of Washington upon the question of the effect of mortgages made by corporations, even from appellant's standpoint, could not

lead to an irresistible conclusion that upon the record before this court the state court would hold the mortgage of May 11th, 1900, to be an unlawful preference. A brief review of these decisions may be of aid to the court.

The case of *Thompson vs. Huron Lumber Co.,* 4 Wash., 600, has been above referred to. The trust fund doctrine was there held to apply, by reason of the facts found, viz.: that the indebtedness evidenced by the notes was long overdue, the directors of the company could not agree, the business was practically stopped, the corporation was insolvent, and the mortgage was intended to act as a shield between the corporation and its other creditors.

The allegations of appellant's complaint fail to meet the facts of the Huron case in the three most important points, viz.: it is not alleged that the mortgage was given entirely to secure a past indebtedness, or that the business of the corporation was stopped or that it had ceased to be a going concern, or that the mortgage was intended to hinder and delay other creditors.

The case of *Leslie vs. Wilshire,* 6 Wash., 282, clearly supports our contention that the decisions of the Washington court are not based upon a construction of constitutional or statutory provisions, but entirely upon the application of the trust fund doctrine to the facts of the particular cases decided. In the last cited case, a corporation which was, as found by the Supreme Court, embarrassed to some extent, and had not enough money on hand to pay all of its indebtedness, executed a chattel mortgage upon its property. The court held the mortgage valid against other creditors, for the reason that notwithstanding the embarrassed condition of the corporation and its inability to pay its indebtedness, its business was regarded as a profitable one, and the evident purpose at the time of the making of the mortgage was to continue the business; and that the mortgage

was made for the purpose of enabling the corporation to continue in business.

The case of *Vincent vs. Snoqualmie Mill Co.,* 7 Wash., 566, also supports such contention. In that case the court, while saying that it was not clearly apparent that the corporation was insolvent at the time the mortgage in question was made, yet it was then being pressed by its creditors and was unable to pay them at that time, and it was doubtful whether the general market value of its property equaled the amount of its indebtedness. The corporation had ceased to operate its property prior to giving the mortgage, and surrendered the possession of its property to the mortgagee, intending to continue its business through the mortgagee in the way of operating its mill. These facts make a stronger showing of actual insolvency than the allegations of appellant's complaint. But the court sustained the mortgage upon the grounds that it appeared to be the evident desire of the corporation to continue in business and to get the matters of the corporation in better shape by getting the title to the property which it was operating in its own hands.

In the case of *Klosterman vs. Mason County Central R. R. Co., et al.,* 8 Wash., 281, the corporation had a mortgage indebtedness of some fifty thousand dollars. In addition to its mortgage indebtedness, it owed one Mason ten thousand dollars for past advances. Mason was liable as a surety upon the mortgage indebtedness. In consideration of the payment by Mason of the mortgage indebtedness and the release of the corporation's indebtedness to him, and the payment by him to the corporation of twelve hundred dollars, the corporation sold and conveyed to Mason practically all the property then owned by it. At this time, the court say, that according to the evidence, the entire property had so depreciated in value that it was not worth more than the amount of the mortgage indebtedness, even if it could have been sold in the market at all. At the time of

the conveyance the corporation was indebted to other persons. The validity of the conveyance to Mason was attacked by one of these creditors. In passing upon the contention of the attacking creditor, that the conveyance was void for the reason that the property of the corporation was a trust fund for the payment of all of the company's debts, the court said (p. 283):

"Conceding that the property of an insolvent corporation is a trust fund for the payment of its debts, and that under such circumstances such corporation cannot ordinarily prefer one creditor over another, does it necessarily follow that the transaction under consideration was void as to unsecured creditors? The answer to this question depends largely upon the power of corporations in this state to manage and dispose of their property. That power is expressed in the statute in this language: 'To purchase, hold, mortgage, sell and convey real and personal property.' From this comprehensive provision it will be seen that the appellant corporation had a right, in the proper conduct of its business, to mortgage its property to secure its debts. And this being so, it had a right to sell, in good faith, any or all of its property in payment of its mortgage liens."

And again at page 288:

"This case is easily distinguishable from Thompson vs. Huron Lumber Co., 4 Wash., 600 (30 Pac., 742), in which this court set aside a fraudulent and preferential mortgage."

It is to be noted that the conveyance to Mason was made not only in satisfaction of the mortgage indebtedness, but in satisfaction of the unsecured indebtedness to Mason. As to this indebtedness Mason stood upon the same footing as the attacking creditor, and if the law of the state of Washington was settled, as claimed by appellant, the court would have been compelled to hold that the conveyance was intended to give an unlawful preference.

In the case of *Roberts vs. the Washington Nat. Bank*, 11 Wash., p. 550, the right of an insolvent corporation to mortgage its property as security for a present advance of money for use in its business is clearly recognized, and such a preference upheld. In the opinion in this case the court distinguishes such preferences, made in consideration of a present advance, from those made wholly in consideration of antecedent indebtedness.

In the case of *Conover vs. Hull*, 10 Wash., 673, the court found that there existed actual fraudulent collusion between the creditors claiming preferences under judgments and the officers of an insolvent corporation, in fraud of the rights of its other creditors. The court, in deciding the case, review at considerable length its former rulings on the question of preferences by insolvent corporations, and the opinion of the court is valuable here chiefly as showing that the question has been always considered and decided by the court with reference only to the trust fund doctrine.

In the case of *Compton vs. Schwabacher Bros. & Co.*, 15 Wash., 306, the preference was claimed under a judgment confessed by a hopelessly insolvent corporation for an antecedent indebtedness, and under circumstances showing, in the opinion of the court, fraudulent collusion between the creditor and the officers of the corporation. In the opinion in this case the court again assert that its decisions regarding such preference rest upon the trust fund doctrine and not upon the application of any statute law. At page 312 the court say:

"Whatever rule may prevail elsewhere, it is now well settled in this state that the assets of an insolvent corporation constitute a trust fund for the benefit of all of its creditors. * * * It is wholly inconsistent with the trust fund theory to permit a race of vigilance to be instituted between the creditors of an insolvent corporation. As between them 'equality is equity.' "

In the case of *Biddle Purchasing Co. vs. Port Townsend*

Steel Wire Nail Co., 16 Wash., 681, the reasons for the decision are clearly stated by the court at page 693:

"The mortgage itself was clearly a preference by an insolvent corporation of one of its creditors. It was executed as security for an antecedent debt. Such a preference cannot be maintained."

In the case of *Cook vs. Moody*, 18 Wash., 114, it was found by the court that the corporation was insolvent at the time it gave the mortgage in question, and further found that no fraud was intended by either party. At page 116 the court say:

"The mere belief that the company might be able to continue its business and pay off its other indebtedness could not alter the legal status of the property and entitle these antecedent debts attempted to be secured by the mortgage to a preference payment, in view of the fact that the respondent's action was promptly commenced after the foreclosure. Had there been an unreasonable delay in this, another question might be presented. As it is, there is nothing in the case to take it out of the general rule, holding such property a trust fund for the benefit of all the creditors, adopted in the numerous cases heretofore decided by us."

In the case of *Washington Mill Co. v. Sprague Lumber Co.*, 19 Wash., 165, the mortgages in question were given by an insolvent corporation to secure individual debts of some of its stockholders. The court clearly recognizes the right of a corporation to mortgage its property for purposes for which the corporation was created, but holds that this corporation had no power under any circumstances to make the mortgages in question.

Van Brocklin vs. Printing Co., 19 Wash., 552. The mortgage was given by an insolvent corporation for the purpose of securing an antecedent indebtedness.

Likewise, in *Carroll vs. Pacific Nat. Bank,* 19 Wash., 639, the transfer of property which was held void was made by an insolvent corporation, known by the creditor to be insolvent, in payment of an antecedent indebtedness.

Likewise, in *Burrell vs. Bennett,* 20 Wash., 644, collateral security was given by an insolvent corporation to a creditor having knowledge of the insolvency to secure an antecedent indebtedness.

If we are right in our understanding of the Washington decisions, then, regardless of the argument that the decisions of the state court have not been based upon a construction of constitutional or statutory law, appellant's contention fails, and his appeal must depend upon the construction of the principles of equity jurisprudence affecting such preferences announced by the courts of the United States. The decisions of the federal courts upon this question are clear, decisive and harmonious. As before pointed out, in the only federal case relied upon by appellant, the Supreme Court of the United States was very careful to declare that the theory of the trust fund doctrine announced by the state court could not be maintained upon general principles of equity jurisprudence. It is not our intention to attempt, in this brief, to make an exhaustive analysis of the decisions of the state and federal courts upon this proposition. It seems that the doctrine originated in the statement of the proposition that the property of a corporation must first be appropriated to the payment of its debts before any portion of it could be distributed to its stockholders.

In the case of *Fogg vs. Blair,* 10 Sup. Court Rep., 338 (133 U. S., 534), this rule is very emphatically stated. After stating the facts, and without making any distinction between railroad or other corporations, the court said:

"It (the trust fund doctrine) does not mean that the property is so affected by the indebtedness of the company that it

cannot be sold, transferred or mortgaged to *bona fide* purchasers for a valuable consideration, except subject to the liability of being appropriated to pay that indebtedness. Such a doctrine has no existence."

In *Wabash, &c., Ry. Co. vs. Ham*, 114 U. S., 587, the court said (p. 394):

"The property of a corporation is doubtless trust funds for the payment of its debts, in the sense that when the corporation is lawfully dissolved, and all its business wound up, or when it is insolvent, all its creditors are entitled, in equity, to have their debts paid out of the corporate property before any distribution thereof among the stockholders. It is also true, in the case of a corporation, as in that of a natural person, that any conveyance of property of the debtor, without authority of law, and in fraud of existing creditors, is void as against them."

In the case of *Hollins, et al., vs. Brierfield Coal & Iron Co.*, 14 Sup. Court Rep., 127 (150 U. S., 371), the court, after careful consideration of the trust fund doctrine as asserted in that case, said:

"A party may deal with a corporation, in respect to its property, in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called to account for fraud, or sometimes even mere mismanagement, in respect thereof; but, as between itself and its creditors, the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, or in any other sense than does an individual debtor. That is certainly the general rule, and, if there be any exceptions thereto, they are not presented by any of the facts in this case. *Neither the insolvency of the corporation*

nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together, gave to these simple contract creditors any lien upon the property of the corporation, nor charged any direct trust thereon." (The italics are ours.)

In the case of *Gould vs. Little Rock M. R. & T. Ry. Co.*, 52 Fed., 680, the court, after referring to the decisions of the Supreme Court of Arkansas sustaining the right of a corporation in failing circumstances to make preferences among its creditors, says:

"The established rule in that state is in harmony with the general, though not quite uniform, current of authorities in this country on the question. * * * The cases which hold the contrary doctrine are bottomed on the erroneous theory that the insolvency of a corporation, in effect, dissolves it, and makes the directors mere trustees to distribute its assets ratably among its creditors. It is undoubtedly true that the property of a corporation is, in one sense, a trust fund for the payment of its debts, but this rule means no more than that the property of a corporation cannot be distributed among its stockholders or applied to any purpose foreign to the legitimate business of the corporation, until its debts are paid. The rule, so far as it relates to payment of debts, is specific whenever the property of a corporation is applied to the payment of any of its *bona fide* debts. The rule, as has been before pointed out, does not prevent a corporation, when solvent or insolvent, from making preferences among its creditors and exercising in good faith absolute dominion over its property in the conduct of its legitimate corporate business, so long as its right to do so is not restrained by statute or judicial proceedings.

The case of *Sanford Fork & Tool Co. vs. Howe*, 157 U. S., 312, has been before referred to. The opinion of the court in

that case seems to meet and effectually answer every allegation relied upon by appellant.

In the case of *Doe vs. Northwestern Coal & Transportation Co.,* 78 Fed., 62, Judge Gilbert, in rendering the decision of the court, after considering other questions raised by the appeal, said (p. 71):

"It is contended that the mortgage of the defendant J. Whalley is invalid, for the reason that at the time it was executed the corporation was insolvent, to his knowledge, and that to permit it under those circumstances to prefer one creditor to others would be to disregard the well-established rule of equity that the property of an insolvent corporation is a trust fund to be held for the equal benefit of all its creditors. There are decisions that uphold this view of the rule, but it is not so held in the Federal courts."

In the case of *Armstrong vs. Chemical National Bank,* 41 Fed., 234, the court considered a preference made by a national banking corporation, which preference was claimed to be void under the provisions of section 5242 of the Revised Statutes of the United States, which prohibits all transfers by any national banking association made after the commission of an act of insolvency, or in contemplation thereof, with a view to the preference of one creditor to another. The court say (p. 238):

"The statute is directed to a preference, not to the giving of security when a debt is created; and if the transaction be free from fraud in fact, and is intended merely to adequately protect a loan made at the time, the creditor can retain property transferred to secure such loan until the debt is paid, even though the debtor is insolvent, and the creditor has reason at the time to believe that to be the fact."

As before pointed out, it is not claimed that complainant had any knowledge, actual or constructive, of the condition in

which appellant charges the corporation's affairs to have been at the time the mortgage was made. There is not the slightest showing of fraud or bad faith, actual or legal. It is clear that the money advanced by complainant to the corporation, at and prior to the giving of the mortgage, and the money advanced subsequent to the giving of the mortgage, were intended to be used, and were in fact used in the prosecution of the corporation's business. No part of any of the advances were repaid, and the corporation retained all of the money loaned to it by complainant for the benefit of its stockholders and creditors.

In the case of *Gould vs. Little Rock, &c., Co., supra,* the court say (52 Fed., 686):

"The attack upon the validity of the trust deed must fail upon another ground. Treating the directors as trustees, it is not open to the company, or any of its creditors, to avoid the security given in pursuance of the direction of the stockholders, as well as the directors, so long as the company retains the money which was loaned in good faith, and actually appropriated to legitimate corporate purposes. The payment of the debt thus contracted is an essential pre-requisite to the avoidance of the deed of trust given to secure its payment. 'And,' in the language of the Court of Appeals of New York, 'this is true whether the pledge was taken for a present or precedent debt. In either case the equity to be regarded equally exists.'"

It seems clear to us that the judgment of the lower court must be sustained. Appellant's whole contention must fail unless the court sustains his claim that the decisions of the Supreme Court of the State of Washington upon this subject are binding and controlling upon the federal courts. The rule established by very numerous decisions of the federal courts is that those courts adopt and follow the decisions of state courts in questions which concern the constitutional laws of the state, but do

not follow state decisions on questions of general or commercial law.

We think we have clearly shown that the Washington decisions are not based on any constitutional or statutory provisions, and further, that the Washington court has not claimed to have considered any such provision. But even if the court should not agree with us in this contention, appellant must still fail, for no decision of the Washington court holds that a mortgage made under the circumstances surrounding the making of this mortgage is invalid. Even should the court believe that this position is not sound, we are certainly right in saying that it cannot be positively said that if this case were before the Washington court the mortgage would be held invalid.

But we respectfully submit that the judgment of the lower court must be affirmed upon another ground. It is contended by appellant that the corporation was insolvent, and that, therefore, a court of equity, upon a proper application, should take charge of the corporation's property, wind up its affairs and convert its assets into money, and make an equal and ratable distribution thereof amongst all of its creditors, disregarding any preference attempted to be given after the corporation became insolvent.

Since the decision of all of the cases cited by appellant or appellees on this appeal, the United States Bankruptcy Act of 1898 has gone into effect. This act covers the whole field of insolvency or bankruptcy, and prescribes an exclusive system for the control of the assets of bankrupts, the determination of preferences claimed against bankrupts, and the winding up of the affairs and business of bankrupts, and the distribution of their property amongst their creditors. By the terms of this act it is provided, in substance, that the transfer by any person (or corporation) of any portion of his (or its) property to one or more of his (or its) creditors, with intent to prefer such creditors over his (or its) other creditors, if made while the person (or corporation) is insolvent, is an act of bankruptcy, and that a petition may be filed against the person (or corporation) who is insolvent and who has committed such act of bankruptcy within four months after the recording or registering of such transfer.

The Bankruptcy Act of 1867 described certain acts of bankruptcy, and provided that the petition might be brought within, in some cases, four, and in others six months, after the act of bankruptcy should have been committed.

The provisions of the two acts are so similar in principle and effect that the construction given to this provision of the

act of 1867 by the federal courts is applicable to the similar provision of the present law.

In the case of *Bean vs. Brookmire* (1 Dillon, 125), 2 Fed. Cas., 1127, Fed. Cas. No. 1168, the court construed the provision of the act of 1867 relating to preferences. The court say:

"The language of the section is, that if any person, being insolvent, or in contemplation of insolvency, within four months of the filing of the petition by or against him, with a view to giving the creditor preference by any of the acts therein mentioned, the act shall be void, and the assignee may recover the property from the person receiving it, if such person had reasonable cause to believe the party insolvent. It is very certain that the act described is not made void by this clause, or by any clause in this section, unless it was done within four months of the filing of the petition by or against the bankrupt, and it is as strong an instance as can well grow out of a negative pregnant that no such act is void for any of the causes there mentioned that was done within the four months."

After discussing the standing of preferences made by insolvents under the common law of the different states, Mr. Justice Miller says:

"The careful and diligent framers of the bankrupt act were fully aware of all that has just been said. But they were about to frame a system of laws, one important feature of which was to provide for the distribution of the property of an insolvent debtor among his creditors, and they adopted wisely, as the general and prevailing rule of distribution, equality among creditors. But they found that this general principle could not without hardship be made of universal application. When a creditor had obtained by fair means a lien upon any property of the bankrupt, that lien ought to be respected. If he had so obtained the payment of the whole or a part of his debt, the payment ought to stand. These exceptions to the general rule

of distribution were, however, liable to be abused, and might be used to defeat the purposes of the bankrupt law. The bankrupt, knowing that he himself would soon be helpless, would desire to pay or secure favorite creditors. They, knowing his liability to pay, and his liability to be called into a bankruptcy court, would naturally desire to secure themselves at the expense of other creditors. In this dilemma, Congress said we cannot prescribe any rule by which a preference would be held to be morally right or wrong; and it would be fatal to the administration of the law of distribution to permit such a question to be raised. We will therefore adopt a conventional rule to determine the validity of these preferences. In all cases where an insolvent pays or secures a creditor to the exclusion of others, and that creditor is aware that he is so when he receives it, he shall run the risk of the debtor's continuance in business for four months. If the law which requires equal distribution, is not called into action for four months, the transaction, if otherwise honest, would stand; but if by the debtor himself, or any of his creditors, that law is invoked within four months, the transaction shall not stand, but the money or property received by the party shall become a part of the common fund for distribution. * * * The thirty-fifth section and the thirty-ninth section, having for the first time set up a rule by which certain payments and transfers of property shall be declared void (a rule at variance with the common law, and with the statutes of the states), very properly limits and defines the circumstances within which this new rule shall operate. These are, among others, * * * and that the transaction must have been recent when the bankrupt law was applied to the case—with a creditor within four months and with the general purchaser within six months."

In *Harvey vs. Crane* (2 Bissell, 496), Fed. Cas. No. 6178, 11 Fed. Cas., 734, the court said:

"A creditor may obtain a preference from an insolvent debtor with knowledge of the insolvency, if within the limitation prescribed by the law, but the possession must be obtained by a complete act within the limitation."

In *Collins vs. Gray* (8 Blatchf., 483), 6 Fed. Cas., 129, Fed. Cas. No. 3013, the transfers in question were made by the bankrupt to his father. After discussing the facts, the court say:

"Taking the transaction as a giving of preference to the father as a creditor, while the debtor was insolvent, or in contemplation of insolvency, and assuming that the father had reasonable cause to believe that his son was insolvent, the case exhibits no features but those described in the first clause of section thirty-five of the bankruptcy act. By that clause, if such a transaction be made within four months before the filing of the petition whereon the debtor is declared bankrupt, the same is declared void, but not otherwise. Although the bankrupt law aims at an equal distribution of all the property of a debtor among his creditors from the time he becomes insolvent or contemplates insolvency, and is intended to disallow preferences given by a debtor to favored creditors, it goes no further, when preference alone is the subject of complaint, then to avoid such as are given within four months before the filing of the petition. If, in all other respects, the transfer is free from fraud or illegality, the law allows no attack to be made upon it after four months have elapsed."

In *Potter vs. Coggeshall,* 19 Fed. Cas., 1138, Fed Cas. No. 11,322, this question is very fully discussed. The court say:

"The answer of the petitioners to these allegations is two-fold. The first is, that assuming the allegation of the fact to be true, the trustee is estopped from impeaching the transaction, because the proceedings in bankruptcy against Dow were not commenced until six months (less one day) after the act

of preference—and not within four months, as expressly required by the first clause of section thirty-five of the bankruptcy act. After the lapse of four months, say they, the preferences—simply preferences which an insolvent debtor may have made, are to be held valid as against all the world, so far as the preferred creditor is concerned. And this, in my judgment, is a sufficient answer."

It is firmly established that all state laws relating to the subject-matter of the federal bankrupt statute are suspended or superseded during the existence of the federal law, even as between citizens of the same state.

In *May vs. Breed,* 7 Cush., 40, the court says: "When a uniform system of bankruptcy under a law of the United States is actually in force, to the extent to which it reaches, it must of necessity suspend state laws, because they would be repugnant."

In *Clarke vs. Rosenda,* 5 Rob. (La.), 33, the court said, discussing the effect of the general bankrupt act of 1841:

"I cannot imagine a more ample investment of jurisdiction than Congress has conferred on the circuit and district courts of the United States; and the extent of the jurisdiction proves that the national legislature, whilst exercising its constitutional power to establish a uniform system of bankruptcy, intended to suspend, if not sweep out of existence, the insolvent laws of the states and the jurisdiction of their tribunals, with ample powers where justice should be administered alike to all, and a general system formed and controlled by a body of judges deriving their authority from the same power that made the law."

In *Thornhill vs. Bank of Louisiana* (1 Woods, 1), 23 Fed. Cas., 1139, Fed. Case No. 13,992, the court said, after quoting from the cases last above cited:

"The Bank of Louisiana is, according to the agreed statement of facts, an insolvent moneyed corporation. Such a corporate body falls within the purview of the general bankrupt law of the United States, and according to the authorities cited, a state law applicable to a like case is in effect suspended by the law of congress. I am of the opinion, therefore, that on the taking effect of the general bankrupt law on June 1, 1867, the law of the state of Louisiana, approved March 14, 1842, providing for the liquidation of banks, was suspended; that the state courts had no jurisdiction to proceed under it, &c., &c."

To the same effect see also

In re Reynolds, 20 Fed. Cas., 612, Fed Cas. No. 11,723.

It is not necessary, in order to suspend the operation of state insolvency laws, that proceedings under the federal bankruptcy act should be instituted.

Ex parte Ames, Vol. 8, Fed. Cas., p. 236; Fed. Cas. No. 4237.

In so far as a state law attempts to administer on the effects of an insolvent debtor and distribute them among creditors, it is to all intents and purposes an insolvent law, although it may not authorize a discharge of the debtor from further liability.

In re Merchants' Ins. Co., 3 Bissell, 162.

In this case Judge Blodgett said (p. 164):

"The object and intent of the general bankrupt law is to place the administration of the affairs of insolvent persons and corporations exclusively under the jurisdiction of the federal courts sitting as courts of bankruptcy, and the enactment of the general bankrupt law now in force suspended all actions and proceedings under state insolvent laws."

And at page 166:

"It also seems clear to us that in so far as a state law attempts to administer on the effects of an insolvent debtor and distribute them among creditors, it is to all intents and purposes an insolvent law, although it may not authorize a discharge of the debtor from further liability on its debts."

In *Blake, Moffitt & Towne vs. Francis-Valentine Co.,* 89 Fed., 691, application was made to the district court of the northern district of California for an injunction to prevent the sale of property of the defendant corporation under an execution issued out of the state court in an action brought by the Donohoe-Kelley Banking Company. At the time the application was made, the Bankruptcy Act of 1898 was in full force and effect, but four months had not elapsed from the date of its passage and therefore no proceedings whatever could be had under it. Nevertheless, the court held that the defendant corporation had, while insolvent, permitted the Donohoe-Kelley Company to obtain by an attachment a preference through legal proceedings, and the court held that therefore the injunction should issue and the sale be prevented, in order that the defendant's property might be preserved until the time should arrive when the remedy afforded by the statute could be resorted to.

In the opinion of Mr. Justice Hawley, at page 694, it is said:

"Upon the interpretation of the act, upon reason and authority, I am of opinion that from the date of the passage of the act, the relation of debtor and creditor, and of one creditor with all other creditors, are to be governed by the provisions of the law enacted on July 1st, 1898."

The mortgage attacked by appellant in his intervening complaint was recorded on the 14th day of May, 1900. Appellant's

intervening complaint was filed in the lower court December 31st, 1900, seven months and seventeen days after the recording of the mortgage. If at that time appellant had filed a petition against the corporation charging the execution, delivery and recording of this mortgage as an act of insolvency, the petition would have been upon proper proceedings dismissed. If at any time after September 14, 1900, a petition in bankruptcy had been filed by the corporation or any creditor upon sufficient grounds, and an assignee appointed, and that assignee had brought an action to set aside this mortgage, his action would have failed.

Even if we should concede, as we do not, that the allegations of the appellant's intervening complaint bring the mortgage of May 11th, 1900, within the provisions of the bankruptcy act, the lapse of four months after the recording of the mortgage without any attack being made upon its validity upon the ground that it was an unlawful preference, made the mortgage entirely valid against all persons.

Under the trust fund doctrine contended for by appellant, a different rule was applied by some state courts to preferences made in good faith by insolvent corporations than was applicable to like preferences made by insolvent individuals. The correctness of this doctrine was never conceded by the federal courts. Having clearly before it the conflicts between the decisions, not only of the courts of the different states but between the courts of some of the states and the federal courts, Congress in its wisdom saw fit to place all insolvent debtors, as well corporations as individuals, upon an equal footing as regards the question of preferences, and to establish a conventional rule by which the validity of preferences made by any insolvent should be decided. As pointed out by the courts in construing the act of 1867, no attempt was made to prescribe any rule by which a

preference would be held to be morally right or wrong. The rule, while a conventional one, seems to be founded in good commercial reason. If a debtor, being insolvent and having publicly preferred one creditor to the exclusion of all others, is permitted by his general creditors to continue in the possession and control of his property and business for a period of four months after giving the preference, it seems reasonable to hold that the general creditors have acquiesced in the giving of the preference, and by such acquiescence have made valid and unassailable the preference which, in the interim, might have been successfully assailed. It is clear that in any bankruptcy proceedings, an attack upon the mortgage in question, made more than four months after it was recorded, would be fruitless; that being so, can it be held that an attack such as is attempted by appellant, made after the lapse of such time, can be sustained?

An assignee appointed under the law expressly enacted for the control and disposition of the property of bankrupts, appointed under a petition filed more than four months after the recording of the mortgage, could not maintain an action to set aside the preference.

Can a judgment creditor who has refused, and still refuses to invoke the aid of the bankruptcy courts, successfully maintain such an attack after the lapse of such period of time?

It has been before pointed out that no question of collusion, fraud or bad faith is attempted to be raised by appellant's complaint. His case is grounded wholly upon the alleged insolvency of the corporation existing without the knowledge of complainant. It is purely a question of a morally rightful preference made in good faith to a *bona fide* creditor receiving it in good faith to secure the repayment of moneys loaned for use, and actually used, in the prosecution of the corporation's business, both before and after the execution of the mortgage. The valid-

ity or invalidity of such a mortgage must be determined by reference to the United States bankruptcy act. Under the provisions of that act the attack comes too late. It is not required by the provisions of the bankruptcy act that knowledge of the making of a preference by an insolvent must be brought home to the general creditors in order to set the four months period running. The recording of the mortgage imports notice. It, however, may not be amiss to point out the fact that appellant's solicitors are also the solicitors for the defendant corporation.

The federal bankrupt law, viewed as operating on the rights of creditors, is a system of remedy. As said by Mr. Brandenburg: "It takes out of the hands of the creditors the ordinary remedial processes, and suspends the ordinary rights which by law belong to creditors and substitutes in their place a new and comprehensive remedy designed for the common benefit of all."

As we understand it, one of the chief objects of the act is to establish a system of dealing with the estates of insolvent debtors which shall be uniform throughout all of the states of the Union, and to vest the administration of that system in the federal courts. It would seem to irresistibly follow that all questions relating to the validity of preferences given by insolvents, and to the form and timeliness of attacks upon such preferences, must be decided by reference to the bankruptcy act. A system under which, in the federal courts, an attack upon a mortgage in one form more than four months after it was recorded, would fail, and a like attack, but made in a different form in the same court after such lapse of time, would succeed, could hardly be called uniform.

In conclusion we respectfully submit,—

First. That the motion to dismiss this appeal should be granted, with costs to appellees.

Second. That should the court find the motion to dismiss the appeal to be not well taken, the judgment of the lower court sustaining the demurrer to appellant's intervening complaint should be sustained, with costs to appellees.

Respectfully submitted,

HAROLD PRESTON,
E. M. CARR,
L. C. GILMAN,

Solicitors for Appellees Henry F. Allen and John H. McGraw, as Receiver.

E. M. CARR, Counsel.